

Testimony of Marc L. Busch¹
To the House Aviation Subcommittee
May 25, 2005

Chairman Mica, Ranking Member Costello, thank you for the invitation to appear before the subcommittee today to discuss global market factors affecting the US jet transport industry. I applaud the subcommittee for its leadership in examining this important topic.

As the commercial rivalry between Boeing and Airbus intensified through the late 1980s, then USTR Ambassador Michael Smith warned a House subcommittee that “decisions about launch aid and things like that should not be taken lightly, either by the governments involved or by the industries involved.”² With the United States and Europe once again on the brink of litigating civil aircraft under international trade rules, Ambassador Smith’s testimony is just as relevant today. Indeed, launch aid “and things like that” continue to be a source of considerable tension in the industry, especially in anticipation of the head-to-head competition between Boeing’s 787 and Airbus’ A350. As was true in the late 1980s, the current dispute centers on U.S. charges that Europe provides *direct* launch aid and other financial support to Airbus, whereas Europe counters that the U.S. gives *indirect* subsidies—notably in the form of NASA and Department of Defense R&D grants—and other assistance to Boeing.³ Is this, as Yogi Berra might have put it, “like déjà vu all over again”?

Some things about this commercial rivalry have certainly not changed. Most saliently, the civil aircraft industry remains a catalyst of economic growth and competitiveness, both because it provides a lot of high-paying jobs, and because it exhibits leading-edge technological spillovers that benefit other sectors. Combined with the industry’s export prowess, these factors ensure that governments will always take a keen interest in civil aircraft manufacturing.⁴

Other things about this commercial rivalry have undoubtedly changed. There are, in particular, two notable differences between the landscape of the current dispute and the one that gave rise to the 1992 Large Civil Aircraft (LCA) Agreement: competition from regional jet makers who are, at times, subsidized; and the negotiation of stricter disciplines on subsidies, coupled with a better dispute settlement mechanism, under the World Trade Organization (WTO). First, the regional jet market, which is dominated by

¹ Marc L. Busch is Associate Professor, Queen’s School of Business, Kingston, Ontario, Canada. As of July 1, 2005, he will be Karl F. Landegger Professor of International Business Diplomacy, School of Foreign Service, Georgetown University.

² *Competitiveness of US Commercial Aircraft Industry*. Hearing before the Subcommittee on Commerce, Consumer Protection and Competitiveness of the Committee on Energy and Commerce, 100th Congress, 1st Session, June 23, 1987, p. 24.

³ See the U.S. request for WTO consultations, *EC and Certain Member States—Measures Affecting Trade in Large Civil Aircraft* (WTO Document WT/DS316/1), and the European request for WTO consultations, *US—Measures Affecting Trade in Large Civil Aircraft* (WTO Document WT/DS317/1).

⁴ Marc L. Busch, *Trade Warriors: States, Firms, and Strategic-Trade Policy in High-Technology Competition* (NY and Cambridge: Cambridge University Press, 1999).

Canada's Bombardier and Brazil's Embraer, is increasingly vying for orders against Boeing and Airbus offerings. Specifically, the Department of Commerce explains that Embraer is "starting to blur the traditional line between large civil aircraft and regional jets" with its 100+ seat offerings, a move Bombardier is "seeking to match" with new aircraft in the 130 seat range.⁵ By crossing the 100 seat threshold that has long defined this market segment, Bombardier and Embraer will compete directly with smaller airplanes from Boeing and Airbus. Thus, while much attention has been paid to the flight test of Airbus' huge A380, which will go head-to-head with Boeing's 747, both companies will increasingly have to contend with Bombardier and Embraer, competition that Boeing's *Current Market Outlook* predicts will be formidable.⁶ More worrisome still, this competition has been subsidized in the past, and there is renewed concern that Canada and Brazil will be backing their national champions as they bring their new products to market. In short, subsidized competition in civil aircraft is a more widespread problem than it was the last time the U.S. and Europe were on the brink of international trade litigation.

Second, and related, the WTO is a more viable forum in which to litigate trade tensions over civil aircraft than was its predecessor, the General Agreement on Tariffs and Trade (GATT). This is because the WTO negotiated stronger disciplines on subsidies, and provides an improved dispute settlement mechanism to adjudicate these disciplines. In the early 1990s, when the U.S. and Europe readied to argue their cases before the GATT, the relevant disciplines on subsidies, and the dispute settlement mechanism, were not widely seen as being up to the task. The dispute settlement mechanism, in particular, was viewed with suspicion, given the possibility that a GATT ruling could be "blocked" by the losing side. Since it is not possible to block rulings at the WTO—or to block requests for authorization to retaliate, for that matter—there is a sense that litigation may be more efficacious this time around.

Taken together, these two differences suggest that WTO litigation may be the right call. For the most part, dispute settlement works by encouraging negotiation in the "shadow of the law." As my research with Eric Reinhardt of Emory University shows, the fullest concessions (i.e., granting improved market access or trade liberalization) are typically negotiated *before* a panel issues a ruling, either in consultations (which precede a panel request) or at the panel stage in advance of a verdict.⁷ We call this "early settlement," and find that, just like under GATT, it tends to produce the most favorable outcomes under the WTO, especially in disputes involving the U.S. and Europe.⁸

⁵ U.S. Department of Commerce, *The U.S. Jet Transport Industry: Competition, Regulation, and Global Market Factors Affecting U.S. Producers* (Washington, DC: International Trade Administration, 2005), pp. 40, 43.

⁶ Boeing, *Commercial Market Outlook* 2004, p. 12.

⁷ Marc L. Busch and Eric Reinhardt, "Developing Countries and GATT/WTO Dispute Settlement," *Journal of World Trade* 37 (4) 2003: 719-735; and Busch and Reinhardt, "Bargaining in the Shadow of the Law: Early Settlement in GATT/WTO Disputes," *Fordham International Law Journal* 24 (1) 2001: 158-172.

⁸ Marc L. Busch and Eric Reinhardt, "Transatlantic Trade Conflicts and GATT/WTO Dispute Settlement," In Ernst-Ulrich Petersmann and Mark A. Pollack (eds), *Transatlantic Economic Disputes: The EU, the US, and the WTO* (Oxford: Oxford University Press, 2003).

Of course, in the current civil aircraft dispute, the U.S. and Europe did *not* settle early in consultations, nor during the recent “cease fire” in the lead up to a panel request. And while it is still possible that an agreement might be reached before a WTO panel rules, this dispute is likely to go the legal distance. What can we expect?

The experience of Canada and Brazil at the WTO is instructive. Both sides challenged each other’s subsidy schemes, chalked up a few legal victories, and won authorization to retaliate. And while neither has followed through on retaliation, the legal victories have done two things. First, the WTO rulings have curtailed the use of certain subsidy programs. For example, Canada won legal victories against two versions of Brazil’s export-financing scheme (PROEX I and PROEX II), and largely handcuffed a third (PROEX III), thereby reshaping the playing field in regional jets. For its part, Brazil prevailed in a case over support Bombardier received on a sale to Air Wisconsin, but failed to convince the WTO that other Canadian subsidy schemes were illegal. These decisions were thus important for the companies involved, and brought greater legal clarity to the issues contested by the two governments. Second, these WTO rulings have pressured both sides to return to the bargaining table to seek a long-term solution to their dispute. Indeed, Canada and Brazil have formed a technical working group to negotiate a lasting peace, one informed by the rulings issued by the Geneva-based trade institution.

In the current U.S.-EC dispute, WTO litigation can be expected to accomplish three things. First, the litigation will help clarify which subsidy programs are illegal under international trade rules, and which are not. Second, the litigation will impact not only the U.S. and Europe, but Canada and Brazil as well, in the sense that WTO rulings influence how subsequent cases are decided. For this reason, Canada and Brazil are likely to reserve “third party” rights in cases brought by on behalf of Boeing and Airbus, looking to influence these legal decisions. Third, the results of this litigation will likely encourage the U.S. and Europe to return to the negotiating table, although to be successful, these talks should also include Canada and Brazil. The 1992 LCA Agreement was forward-looking in this regard, recognizing the need to “multilateralize” disciplines on civil aircraft subsidies despite the bilateral nature of the accord. While this was visionary at the time, the need for multilateral talks today is simply a reflection of the new landscape of the civil aircraft industry.